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Poland:
resisting recession

Economic performance in the first quarter of 2009 proved much stronger than widely expected. The GDP growth rate, though of unimpressive magnitude, turned positive (+0.8%). This is consistent with the earlier wiiw expectations. Consumption, both private and public, has been robust, contributing 3.5 percentage points (p.p.) to the overall GDP growth. The strong rise in private consumption was a natural consequence of rising wages and employment (the latter primarily outside the corporate sector). The GDP share of private consumption recorded in the first quarter of 2009 is unchanged as compared with the same periods of 2008 and 2007. This may suggest that the household saving propensity has not so far been affected by the events. Apparently, households did not engage in precautionary saving. The public mood may have been influenced by the government's persistence in claiming that Poland would remain an island of prosperity.

Exports of goods and services fell almost 15% in real terms – less than imports which fell close to 18%. After several years of having been a major drag on overall growth, foreign trade has now been actively supportive, adding another +1.9 p.p. to the GDP growth rate. Finally, while gross fixed investment increased by some 1.2%, a massive decline in inventories resulted in the contraction of overall gross capital formation by close to 24% – which shaved off some 4.6 p.p. from the overall GDP growth rate. Gross value added in industry contracted by close to 5%, but rose in construction (by 3.4%) and market and non-market services (by 3.1% and 4.9% respectively).

Industrial sales fell by 10% in the first four months of the year. Sales in branches producing primarily intermediate and investment goods dropped by some 15%. Sales of nondurable and durable consumer goods rose by 2.6% and 0.3% respectively. (Sales of pharmaceuticals, computers, electronic and optic equipment performed quite well, but the volume of sales of the motor vehicles branch shrank by 27%.) Employment in industry fell by some 4%, pulling the labour productivity (sales per employee) down by some 6%. Unit labour cost in industry rose about 7%. Industry's financial result from the sale of products (sale revenues minus own costs) did not fall much in the first quarter, by 3% only vs. the same period of 2008. However, the consolidated post-tax net profit in industry declined by 62%. Other segments of the non-financial corporate sector performed similarly. The whole non-financial corporate sector's result on the sale of goods and services reached PLN 22 billion – but the consolidated net profit was PLN 9.8 billion (less than half of that earned a year earlier).

The discrepancy between these two magnitudes is attributed to losses suffered on financial operations, which rose 20-fold in the first quarter of 2009 (from less than PLN 0.5 billion a year earlier). Prominent among these operations was speculation against the euro/Swiss franc.[1]

Lower profits have not substantially impaired the liquidity position of non-financial firms. According to the April business climate survey of the National Bank of Poland, close to 40% of non-financial corporations dispose of cash reserves in excess of current needs, close to 70% of firms do not report liquidity problems.

No crisis of any sort has occurred in the banking sector, and no commercial bank has obtained any tangible public support. (The PLN 5 billion transferred recently to the state-owned BGK bank is planned to facilitate the extension of loans – and especially loan guarantees – to small and medium-sized enterprises.) The easing of monetary policy, lowering the reserve ratio and the facilitation of access to liquidity (also foreign exchange) from the National Bank of Poland proved sufficient to avert potential difficulties.[2] Nonetheless, banks' financial position has weakened. Their net profits totalled slightly over PLN 2 billion in the first quarter of 2009. This is about half of the amount reported a year earlier. It must be added though that banks have made large provisions whose level has risen to PLN 2.6 billion recently (from 0.7 billion at the end of the first quarter of 2008). Larger provisions are to counter higher risks following the deterioration of banks' balance sheets. That deterioration has much to do with the depreciation of the zloty which augmented the weight of banks' fairly large foreign liabilities. Also, banks' current activities are less lucrative than in 2008 when interest costs were much lower. Moreover, the share of problematic loans has been on the rise. The scale of that rise is still moderate: at the end of March 2009 the share of such loans stood at 5.3%, up from 4.4% at the end of 2008. At the same time the structure of banks' financing has somewhat deteriorated. The loans/deposit ratio stands at 1.12 (from 1.0 a year ago). But it must be remembered that the current ratio is still very low by international standards.

The stock of bank loans to households, non-financial corporations and non-monetary financial corporations rose by 5.7% nominally in the first quarter of 2009. In the same period of 2008 the stock of loans had increased by 7.2%. Obviously, the demand for (and supply of) loans is weaker than a year ago. Significantly though, the interest rates on loans of any maturity (and also on deposits) have been declining in the first quarter of 2009 (after having risen strongly in the second half of 2008). This would suggest that banks are in fact willing to expand credits (to creditworthy firms at least). But such firms may tend to be even more risk-averse. This is understandable, for the time being. The stock of credit to non-financial corporations increased by 4.4% in the first quarter of 2009 – while the

[1] Throughout the first half of 2008 the continuing steep appreciation of the zloty seduced very many managers and entrepreneurs to enter into currency (call) option contracts with banks (primarily those located abroad). The steep depreciation of the zloty in the closing months of 2008 and in January/February 2009 taught a painful lesson to the hapless newcomers to the financial markets.

[2] The measures taken to strengthen the financial system include, among others, the introduction of the deposit guarantee (up to EUR 50,000), increased frequency of open market operations, extended maturity of liquidity provisions, availability of foreign exchange swaps, lower haircut on Lombard credit, widened range assets accepted as collateral.

stock of credit to households rose by 7%. Even if these numbers are somewhat inflated on account of the depreciation of the zloty (and the implied rise in the value of credit assets denominated in foreign currencies[3]) it is clear that the Polish credit market is far from frozen. The credit liabilities/GDP ratios remain fairly low (less than half of the EU-27 levels), the costs servicing these liabilities are correspondingly less painful.

The local repercussions of the global financial crisis that were felt very strongly in the fourth quarter of 2008 included massive outflows of portfolio investment, a precipitous fall in equity prices on the Warsaw Stock Exchange, rising yields on government bonds, and contracting official foreign reserves. The most visible of the repercussion was the spectacular weakening of the Polish currency: The average monthly PLN/EUR exchange rate rose from 3.37 in September to 4.02 in December – the level that had previously obtained in 2000 and 2005. These tendencies continued well into 2009. The turning point came in late February after the PLN/EUR rate touched the level of 5. Soon thereafter the zloty started strengthening. For some time now it has been oscillating around 4.5. The stock exchange has recovered as well, the WIG indices have returned to their pre-crisis (October) levels. Profitability of government bonds has declined significantly, capital inflows have strengthened. In the first quarter of 2009 Poland received, according to preliminary estimates, EUR 3.7 billion in capital inflows, up from 2.3 billion in the preceding quarter.

There have been some good grounds for the recovery of confidence of foreign investors. Apart from the absence of any turmoil in the domestic banking system and the absence of any signs of public sector deficits running out of control, there has been a spectacular improvement on the current account. A current account deficit of a mere EUR 79 million is reported for the first quarter of 2009 – to be compared with EUR 4.7 billion a year earlier and 5.1 billion in the last quarter of 2008. Foreign trade did the trick. The balance of payments deficit in goods trade stands now at EUR 0.5 billion (down from 3.2 and 4.7 billion respectively).

The confidence in the Polish economy is likely to be further strengthened by the recent (May) IMF decision to grant the access to a Flexible Credit Line of USD 20.6 billion. There are no conditions attached to that credit and the costs involved are fairly low (0.27% per annum). The credit, which represents an additional reserve that the Polish authorities could use under extraordinary circumstances (e.g. to counter a major speculative attack), will undoubtedly facilitate access to cheaper foreign borrowing. Poland's standing should increase. Any remaining doubts about the country's ability to service its short-term foreign debt should be dispelled. However, the IMF credit comes long after the Polish currency and stock exchange have returned to quite satisfactory levels entirely on their own. It would be unfortunate if the IMF credit contributed to a return of excessive appreciation of the zloty, excessive capital inflows and to a build-up of another bubble on the Warsaw Stock Exchange.

3 At the beginning of the fourth quarter of 2008 some 32% of household debt was denominated in foreign currencies, the respective figure for the non-financial corporations was 18.7%. The share of foreign-denominated loans and other claims in total debt of households and non-financial corporations was 27.8%, fairly low if compared with ratios reported in other NMS.

The public sector fiscal deficit in 2008 turned out to be larger than maintained by the Finance Ministry. The deficit in 2009 will certainly be even larger, quite possibly in excess of 5% of the GDP. The rise in the deficit quite automatically follows from the GDP growth falling short of the levels underlying the current budget plan. One can expect the revision of the budget plan some time this coming summer. It is certain that the eventual revisions will attempt to contain the deficit (possibly via higher taxes). Given the restraints perceived by the government, and its cherished beliefs, no meaningful[4] additional fiscal stimulus is to expected.

The chances of Poland resisting recession in the coming quarters are fairly high. Individual GDP components may behave well. Further reductions in inventories, coming on top of the dramatic reductions in the first quarter, may be more moderate. The overall impact of gross capital formation may be more benign, even if gross fixed investment stagnates. Given low household debt and still encouraging labour market/wage developments so far, private consumption will probably perform not much worse that in the first quarter. Exports of goods and services are unlikely to perform any better, even if the domestic currency does not strengthen much. But, if the zloty remains properly weak, imports may be expected to fall further.[5] On the whole foreign trade may continue to strongly support the overall growth. Whether or not this scenario will materialize depends primarily on the behaviour of the zloty exchange rate.

That Poland is currently performing much better than other NMS is, to some extent, a matter of the country's size, its relatively low levels of exports and imports and the quite diversified production structure. Under deep depreciation of the domestic currency, these features turn out to be advantageous: the fall in exports is overcompensated by the fall in imports – the latter being at least partly substituted by domestic production. In smaller, more export-specialized countries the adjustments in imports are less pronounced even under quite strong currency depreciation.

Apart from that, Poland's domestic financial system turns out to be in good shape, with the debt levels (households', government's and the corporate sector's) significantly lower than elsewhere. This fact is not a sign of an exceptionally clever policy. Instead, it follows from the brevity of the preceding GDP growth speed-up which started only in 2006 and did not have time to reach unsound proportions which characterized most other NMS.

4 The draft 'anti-crisis package' presented recently (2 June 2009) stipulates, among others, temporary subsidization of employment in firms that otherwise would have to fire workers. The package's estimated cost is about PLN 1 billion – equivalent to 0.08% of the GDP.

5 The current import propensity (imports/GDP) is 43.4%. This is less than observed in the first quarters of 2007 and 2008 when the strong zloty resulted in propensities equal to 44.6% and 45.6% respectively. Earlier on the economy prospered very well with much lower import propensities (e.g. 41% in 2006 or 37.3% in 2005). Should the zloty stay weak, the domestic production has good chances to replace a great deal of import items.

Table PL

Poland: Selected Economic Indicators

	2005	2006	2007	2008 1)	2008	2009	2009	2010	2011
					1st quarter			Forecast	
Population, th pers., average	38165.4	38141.3	38120.6	38123.0	38110	38138	.	.	.
Gross domestic product, PLN bn, nom. 2)	983.3	1060.0	1175.3	1271.7	298.0	314.5	1320	1370	1450
annual change in % (real) 2)	3.6	6.2	6.6	5.0	6.1	0.8	0.8	1.5	3
GDP/capita (EUR at exchange rate)	6400	7100	8100	9500	.	.	.	.	.
GDP/capita (EUR at PPP)	11500	12400	13400	14100	.	.	.	.	.
Consumption of households, PLN bn, nom. 2)	614.3	652.8	701.5	768.2	193.9	205.9	.	.	.
annual change in % (real) 2)	2.1	5.0	5.0	5.4	5.6	3.3	3	3	5
Gross fixed capital form., PLN bn, nom. 2)	179.2	208.3	253.8	279.4	45.1	46.8	.	.	
annual change in % (real) 2)	6.5	14.9	17.6	8.1	15.7	1.2	-4	4	8
Gross industrial production (sales) 3)4)									
annual change in % (real)	4.1	12.0	9.6	3.6	8.2	-10.0	-5	4	6
Gross agricultural production									
annual change in % (real)	-0.7	-1.1	5.2	-4.0	.	.	.	.	.
Construction industry (build.& civil engin.) 3)4)									
annual change in % (real)	9.1	15.0	16.1	12.7	15.9	3.1	.	.	.
Employed persons - LFS, th, average	14115.6	14593.6	15240.5	15799.6	15515.0	15714.0	.	.	.
annual change in %	2.3	3.4	4.4	3.7	4.6	1.3	-1	0.5	1
Unemployed persons - LFS, th, average	3045.4	2344.3	1618.8	1210.7	1361.0	1414.0	.	.	.
Unemployment rate - LFS, in %, average	17.7	13.8	9.6	7.1	8.1	8.3	9	10	9
Reg. unemployment rate, in %, end of period	17.6	14.8	11.4	9.5	10.9	11.2	.	.	.
Average gross monthly wages, PLN	2360.6	2476.9	2691.0	2960.0	3057.8	3249.3 3)	.	.	.
annual change in % (real, gross)	1.8	4.0	6.3	5.5	7.5	3.2 3)	3.5	3.5	4
Consumer prices (HICP), % p.a.	2.1	1.3	2.6	4.2	4.5	3.6	3.3	2.6	2.5
Producer prices in industry, % p.a. 4)	0.7	2.2	2.3	2.6	2.6	5.0	.	.	.
General governm.budget, EU-def., % GDP 5)									
Revenues	39.1	39.9	40.2	39.2	.	.	38.5	39.5	40.0
Expenditures	43.4	43.8	42.1	43.1	.	.	43.0	43.0	42.5
Net lending (+) / net borrowing (-)	-4.3	-3.9	-1.9	-3.9	.	.	-4.5	-3.5	-2.5
Public debt, EU-def., % of GDP 5)	47.1	47.7	44.9	47.1	.	.	46.0	45.5	45.0
Discount rate of NB % p.a., end of period	4.8	4.3	5.3	5.3	6.0	4.0	3.5	3.5	4
Current account, EUR mn 6)	-3016	-7443	-14587	-19753	-4732	-79	-5000	-7000	-10000
Current account in % of GDP	-1.2	-2.7	-4.7	-5.5	-5.7	-0.1	-1.7	-2.2	-2.9
Exports of goods, BOP, EUR mn 6)	77562	93382	105883	120146	30144	23248	102100	114000	122600
annual growth rate in %	17.8	20.4	13.4	13.5	21.2	-22.9	-15	12	7.5
Imports of goods, BOP, EUR mn 6)	79804	98918	118249	136798	33391	23750	109400	118700	127000
annual growth rate in %	13.4	24.0	19.5	15.7	22.5	-28.9	-20	8.5	7
Exports of services, BOP, EUR mn 6)	13105	16349	20930	24156	5102	4399	20000	.	.
annual growth rate in %	21.2	24.8	28.0	15.4	14.9	-13.8	.	.	.
Imports of services, BOP, EUR mn 6)	12520	15768	17523	20688	4578	3829	13000	.	.
annual growth rate in %	16.1	25.9	11.1	18.1	23.3	-16.4	.	.	.
FDI inflow, EUR mn 6)	8330	15737	16672	11058	3442	1925	.	.	.
FDI outflow, EUR mn 6)	2767	7122	3500	2358	893	454	.	.	.
Gross reserves of NB excl. gold, EUR mn	34535	35237	42675	42299	46729	43852	.	.	.
Gross external debt, EUR mn	112316	128870	158441	171826	169884	.	.	.	.
Gross external debt in % of GDP	44.1	46.6	48.4	56.1	55.5	.	.	.	.
Average exchange rate PLN/EUR	4.02	3.90	3.78	3.51	3.58	4.50	4.5	4.3	4.2
Purchasing power parity PLN/EUR	2.23	2.25	2.31	2.37	.	.	.	.	.

1) Preliminary. - 2) According to ESA'95 (FISIM adjusted and real change based on previous year prices). - 3) Enterprices with more than 10 employees. - 4) Quarterly data and forecasts according to NACE Rev. 2. - 5) According to ESA'95 excessive deficit procedure; forecast wiiw estimate. - 6) 2005-2007 including Special Purpose Entities (SPE).

Source: wiiw Database incorporating Eurostat and national statistics. Forecasts by wiiw.